

is not a personal holding company if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations. See section 542(c)(7).

(3) *Foreign personal holding companies.* For the mandatory inclusion in the gross income of the United States shareholders of the undistributed foreign personal holding company income of a foreign personal holding company, see section 551 and the regulations thereunder.

(4) *Controlled foreign corporations—(i) Subpart F income and increase of earnings invested in U.S. Property.* For the mandatory inclusion in the gross income of the U.S. shareholders of the subpart F income, of the previously excluded subpart F income withdrawn from investment in less developed countries, of the previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, and of the increase in earnings invested in U.S. property, of a controlled foreign corporation, see sections 951 through 964, and the regulations thereunder.

(ii) *Certain accumulations of earnings and profits.* For the inclusion in the gross income of U.S. persons as a dividend of the gain recognized on certain sales or exchanges of stock in a foreign corporation, to the extent of certain earnings and profits attributable to the stock which were accumulated while the corporation was a controlled foreign corporation, see section 1248 and the regulations thereunder.

(5) *Changes in tax rate.* For provisions respecting the effect of any change in rate of tax during the taxable year on the income of a foreign corporation, see section 21 and the regulations thereunder.

(6) *Consolidated returns.* Except in the case of certain corporations organized under the laws of Canada or Mexico and maintained solely for the purpose of complying with the laws of that country as to title and operation of property, a foreign corporation is not an includible corporation for purposes of the privilege of making a consolidated return by an affiliated group of

corporations. See section 1504 and the regulations thereunder.

(7) *Adjustment of tax of certain foreign corporations.* For the application of pre-1967 income tax provisions to corporations of a foreign country which imposes a more burdensome income tax than the United States, and for the adjustment of the income tax of a corporation of a foreign country which imposes a discriminatory income tax on the income of citizens of the United States or domestic corporations, see section 896.

(f) *Effective/applicability date.* This section applies for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.881-1 (Revised as of January 1, 1971).

(Secs. 7805 (68A Stat. 917; 26 U.S.C. 7805) and 7654(e) (86 Stat. 1496; 26 U.S.C. 7654(e)) of the Internal Revenue Code of 1954)

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§ 1.881-2 Taxation of foreign corporations not engaged in U.S. business.

(a) *Imposition of tax.* (1) This section applies for purposes of determining the tax of a foreign corporation which at no time during the taxable year is engaged in trade or business in the United States. However, see also § 1.882-2 where such corporation has an election in effect for the taxable year in respect to real property income or receives interest on obligations of the United States. Except as otherwise provided in § 1.871-12, a foreign corporation to which this section applies is not subject to the tax imposed by section 11 or section 1201(a) but, pursuant to the provisions of section 881(a), is liable to a flat tax of 30 percent upon the aggregate of the amounts determined under paragraphs (b) and (c) of this section which are received during the taxable year from sources within the United States. Except as specifically provided in such paragraphs, such amounts do not include gains from the sale or exchange of property. To determine the source of such amounts, see sections

861 through 863, and the regulations thereunder.

(2) The tax of 30 percent is imposed by section 881(a) upon an amount only to the extent the amount constitutes gross income.

(3) Deductions shall not be allowed in determining the amount subject to tax under this section.

(4) Except as provided in §1.882-2, a foreign corporation which at no time during the taxable year is engaged in trade or business in the United States has no income, gain, or loss for the taxable year which is effectively connected for the taxable year with the conduct of a trade or business in the United States. See section 864(c)(1)(B) and §1.864-3.

(5) Gains and losses which, by reason of section 882(d) and §1.882-2, are treated as gains or losses which are effectively connected for the taxable year with the conduct of a trade or business in the United States by such a foreign corporation shall not be taken into account in determining the tax under this section. See, for example, paragraph (c)(2) of §1.871-10.

(6) Interest received by a foreign corporation pursuant to certain portfolio debt instruments is not subject to the flat tax of 30 percent described in paragraph (a)(1) of this section. For rules applicable to a foreign corporation's receipt of interest on certain portfolio debt instruments, see sections 871(h), 881(c), and §1.871-14.

(b) *Fixed or determinable annual or periodical income*—(1) *General rule.* The tax of 30 percent imposed by section 881(a) applies to the gross amount received from sources within the United States as fixed or determinable annual or periodical gains, profits, or income. Specific items of fixed or determinable annual or periodical income are enumerated in section 881(a)(1) as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments, but other items of fixed or determinable annual or periodical gains, profits, or income are also subject to the tax as, for instance, royalties, including royalties for the use of patents, copyrights, secret processes and formulas, and other like property. As to the determination of fixed or determinable an-

nual or periodical income, see paragraph (a) of §1.1441-2. For special rules treating gain on the disposition of section 306 stock as fixed or determinable annual or periodical income for purposes of section 881(a), see section 306(f) and paragraph (h) of §1.306-3.

(2) *Substitute payments.* For purposes of this section, a substitute interest payment (as defined in §1.861-2(a)(7)) received by a foreign person pursuant to a securities lending transaction or a sale-repurchase transaction (as defined in §1.861-2(a)(7)) shall have the same character as interest income received pursuant to the terms of the transferred security. Similarly, for purposes of this section, a substitute dividend payment (as defined in §1.861-3(a)(6)) received by a foreign person pursuant to a securities lending transaction or a sale-repurchase transaction (as defined in §1.861-2(a)(7)) shall have the same character as a distribution received with respect to the transferred security. Where, pursuant to a securities lending transaction or a sale-repurchase transaction, a foreign person transfers to another person a security in the interest on which would qualify as portfolio interest under section 881(c) in the hands of the lender, substitute interest payments made with respect to the transferred security will be treated as portfolio interest, provided that in the case of interest on an obligation in registered form (as defined in §1.871-14(c)(1)(i)), the transferor complies with the documentation requirement described in §1.871-14(c)(1)(ii)(C) with respect to the payment of substitute interest and none of the exceptions to the portfolio interest exemption in sections 881(c) (3) and (4) apply. See also §§1.871-7(b)(2) and 1.894-1(c).

(c) *Other income and gains*—(1) *Items subject to tax.* The tax of 30 percent imposed by section 881(a) also applies to the following gains received during the taxable year from sources within the United States:

- (i) Gains described in section 631 (b) or (c), relating to the treatment of gain on the disposal of timber, coal, or iron ore with a retained economic interest;
- (ii) [Reserved]

(iii) Gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, or other like property, or of any interest in any such property, to the extent the gains are from payments (whether in a lump sum or in installments) which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated under section 871(e) and § 1.871-11 as being so contingent.

(2) *Determination of amount of gain.* The tax of 30 percent imposed upon the gains described in subparagraph (1) of this paragraph applies to the full amount of the gains and is determined (i) without regard to the alternative tax imposed by section 1201(a) upon the excess of net long-term capital gain over the net short-term capital loss; (ii) without regard to section 1231, relating to property used in the trade or business and involuntary conversions; and (iii) except in the case of gains described in subparagraph (1)(ii) of this paragraph, whether or not the gains are considered to be gains from the sale or exchange of property which is a capital asset.

(d) *Credits against tax.* The credits allowed by section 32 (relating to tax withheld at source on foreign corporations), by section 39 (relating to certain uses of gasoline and lubricating oil), and by section 6402 (relating to overpayments of tax) shall be allowed against the tax of a foreign corporation determined in accordance with this section.

(e) *Effective date.* Except as otherwise provided in this paragraph, this section applies for taxable years beginning after December 31, 1966. Paragraph (b)(2) of this section is applicable to payments made after November 13, 1997. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.881-2 (Revised as of January 1, 1971).

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§ 1.881-3 Conduit financing arrangements.

(a) *General rules and definitions—(1) Purpose and scope.* Pursuant to the authority of section 7701(l), this section provides rules that permit the district director to disregard, for purposes of section 881, the participation of one or more intermediate entities in a financing arrangement where such entities are acting as conduit entities. For purposes of this section, any reference to tax imposed under section 881 includes, except as otherwise provided and as the context may require, a reference to tax imposed under sections 871 or 884(f)(1)(A) or required to be withheld under section 1441 or 1442. See § 1.881-4 for recordkeeping requirements concerning financing arrangements. See §§ 1.1441-3(j) and 1.1441-7(d) for withholding rules applicable to conduit financing arrangements.

(2) *Definitions.* The following definitions apply for purposes of this section and §§ 1.881-4, 1.1441-3(j) and 1.1441-7(d).

(i) *Financing arrangement—(A) In general.* Financing arrangement means a series of transactions by which one person (the financing entity) advances money or other property, or grants rights to use property, and another person (the financed entity) receives money or other property, or rights to use property, if the advance and receipt are effected through one or more other persons (intermediate entities) and, except in cases to which paragraph (a)(2)(i)(B) of this section applies, there are financing transactions linking the financing entity, each of the intermediate entities, and the financed entity. A transfer of money or other property in satisfaction of a repayment obligation is not an advance of money or other property. A financing arrangement exists regardless of the order in which the transactions are entered into, but only for the period during which all of the financing transactions coexist. See *Examples 1, 2, and 3* of paragraph (e) of this section for illustrations of the term financing arrangement.

(B) *Special rule for related parties.* If two (or more) financing transactions involving two (or more) related persons would form part of a financing arrangement but for the absence of a financing